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Item 3 of the provisional agenda

INTERDEPENDENCE OF THE PROBLEMS OF TRADE, DEVELOPMENT FINANCE AND THE INTERNATIONAL MONETARY SYSTEM

Economic consequences of the present crisis: a preliminary assessment

Note by the UNCTAD secretariat

1. This note provides a preliminary sketch of how a continuation of the crisis in the Persian Gulf area might affect the world economy, in particular developing countries. It begins with a discussion of the consequences of the cut in exports of crude oil and refined products, and goes on to identify the main channels through which the cut in Iraqi and Kuwaiti imports and payments will affect developing countries. It then concludes with some policy suggestions. The note does not discuss actions which have already been taken to compensate countries adversely affected by the situation, or the economic impact on countries receiving the very large flow of displaced expatriates, owing to the extreme fluidity of the situation in those respects.

I. Exports

2. To assess the embargo's likely impact on petroleum prices, the working assumption is that in its absence OPEC members would, in line with their July agreement, have reduced their total production to 22.5 million barrels per day. That agreement sought to leave a 1 m b/d gap between world consumption and production for the next year, to be covered by the use of privately-held stocks, and to raise prices to $21 per barrel. It is generally thought that other oil-exporting countries can increase output by 3.4-3.9 m b/d to

compensate for the loss of Iraqi and Kuwaiti exports; the scope for increasing output is greatest in Saudi Arabia. Thus, 22.5 m b/d will in all probability be attained. The remaining gap between consumption and production is therefore unlikely to differ much from what had been in prospect, and amounts to a small fraction of total privately-held oil stocks (estimated at over 4.4 billion barrels).

3. In normal circumstances such a shortfall could be covered for an extended period by the use of stocks, without causing prices to escalate sharply. However, present circumstances are anything but normal. As long as acute uncertainties persist regarding the course and outcome of the crisis, the behaviour of prices will be dominated not so much by current supply and demand - and still less by long-term fundamentals - as by purely subjective judgements formed on the basis of instinct and "hunch": the chances of a war cannot be calculated on the basis of statistical probabilities in the same way as, for instance, the risk of accidents. Continued fears that the production capabilities of certain major oil producers might be damaged by armed conflict in the Gulf will cause stocks to remain high and perhaps even rise further, pushing prices up. What is more, expectations - and hence stock levels and prices - will tend to fluctuate, perhaps extremely sharply if improvements and deteriorations in the climate follow each other in quick succession. Besides, it will be hard to avoid speculative bubbles based on actors' trying to guess how others' expectations will change over time. Great turbulence and volatility may therefore be in store.

4. Continued unpredictability will damage economic activity in developed countries. For one thing, it will deter purchases of durable goods, especially those whose economic viability is linked to energy costs. (For instance, consumers may not be able to decide between big and small cars, and enterprises will not be able to compare the likely future profitability of different types of capital equipment.). If expenditures are postponed on a large scale, economic activity as a whole will be depressed. Perhaps even more important, oil price volatility will increase uncertainty over the future course of inflation and interest rates, accentuate speculation, and heighten the instability of financial markets - something which has already been the source of serious problems for the world economy, as explained in the Trade and Development Report, 1990.

5. The upshot will be increased liquidity preference, shortened time-horizons, upward pressure on interest rates, and dampened willingness to borrow, lend, spend and invest. The quantitative magnitude of the impact is hard to forecast since the relevant experience is missing. Although oil prices have moved abruptly from time to time over the past two decades, and have been extremely unstable in the past few years, prices have usually been governed by factors much less subjective than guesses about unknowable future political and military outcomes.

6. The higher average level of petroleum prices (as distinct from their volatility) will also act to depress overall output and to put upward pressure on the price level. However, the strength of this stagflationary effect will be moderate if oil prices are in the $25-$30 range, since that would represent a recovery from the low levels to which they had dropped in the 1980s ($30 for a barrel of oil today is equivalent in real terms to about 85 per cent of the average level of the past decade, and about 120 per cent of the level of the past five years). Since economic activity in the OECD area was already

decelerating before the Gulf crisis and, as noted above, may be further damaged by the new uncertainties those events have produced, restrictive macroeconomic policy stances would be inappropriate, since they might greatly depress employment and growth. The macroeconomic policy challenge lies in preventing a wage-price spiral rather than in deflating aggregate demand. Income policies may be needed instead. However, the policy dilemma will be intense as long as oil markets remain disturbed.

7. For oil-importing developing countries, as well as other oil-importers with tight foreign exchange constraints, it is the rise in oil prices which is problematic, rather than the uncertainty. For oil-importing developing countries taken as a whole, each $1 change in oil prices affects the import bill by some $2 billion. Thus, if oil prices average $30, import costs will have risen over the space of a single year by about $25 billion or 10 per cent of export earnings after payment of debt service obligations, compared to what had been in store at the prices prevailing some months before the crisis. Some developing countries can absorb even a significant increase in oil prices, but for many even a moderate rise represents a severe burden because of the precariousness of their financial situation. If, in addition, interest rates escalate, and recessionary pressures on industrialized countries gather momentum and depress raw material prices and demand for developing countries' exports generally, the damage will be all the greater. The first casualty would be the international debt strategy.

8. As for oil-importing East European countries, the recent increase in oil prices will have a much more pronounced effect than those of the past because recent changes in the pricing and settlements system in CMEA will require Soviet oil to be priced at the current world market price and to be paid for in convertible currency. Each $1 rise in the oil price will therefore raise their import bill by about $0.5 billion. Unless offset, a $30 price continued indefinitely would seriously jeopardize those countries' efforts to achieve stability and growth.

9. The oil revenues of oil-exporting countries will rise, especially those which can step up production the most. A number of oil-exporting countries (for instance, those with acute debt-servicing difficulties or vast post-war reconstruction needs), will use the additional income to alleviate an extremely tight financial constraint. In those countries that are highly indebted, part of the gain may be reflected in higher debt service payments rather than in investments, imports and growth. A few oil exporters, however, will accumulate substantial surpluses, even after meeting the higher defence bills occasioned by the crisis, except inasmuch as they use their windfall gains to mitigate the impact on the countries adversely affected.

10. The embargo will also interrupt exports of refined products, which have been significant for Kuwait; at the same time, the military build-up will increase demand for such products. There is generally thought to be insufficient excess capacity elsewhere to make up for all the loss. Refineries elsewhere that have been using Iraqi and Kuwaiti crude may also face difficulties, depending on the quality of the crudes produced to make up for the embargo. Therefore, tighter market conditions and higher prices may be expected for a number of products during the embargo.

READEX FICHE

II. Imports and financial transactions

11. Since the total annual imports of Iraq and Kuwait prior to the embargo were running at around $15 billion - i.e. 0.5 per cent of world imports - and comprised a wide range of goods and services, the effect on world trade as a whole will be negligible. However, the impact on certain countries and on the markets for certain goods is likely to be considerable.

12. Almost one quarter of imports of goods and non-factor services were supplied by developing countries, and five such countries accounted for 90 per cent of that figure; for each of them, exports to Iraq and Kuwait amounted to more than 10 per cent of total exports.

13. Remittances by workers from developing countries amounted to over $3 billion, the bulk of which was accounted for by seven countries; in one of them, remittances almost matched merchandise exports. It may also be noted that many emigrants have also lost their stock of savings, and that countries of emigration will face the cost of absorbing returning workers.

14. Receipts of investment income from Iraq and Kuwait by developing countries were largely accounted for by three to four countries, all of them exporters of manufactures. These countries also have assets in Iraq and Kuwait.

15. The embargo will also affect the servicing of debts, including trade credits and other short-term loans contracted by companies in Iraq and Kuwait. On the other hand, the servicing of debts to enterprises in those countries could also be interrupted. Financial activity in the region generally will be adversely affected, and permanent damage may be inflicted on off-shore centres.

16. The flow of new loans, grants and direct investments from Kuwait will be significantly affected owing to the disruption of the Kuwaiti economy, the loss of control by the Kuwaiti Government of much of its administrative machinery (including the infrastructure of financial institutions such as development finance agencies) and shifts in priorities caused by the crisis. The financing of both new projects in developing countries and those under construction could well be affected, as well as the rhythm of Kuwaiti contributions to international financial agencies. The flow of Iraq's debt service payments is likely to remain suspended, with a significant impact on three to four developing countries.

17. The impact on the countries affected will depend partly on how far they can find alternative outlets for their exports of goods and services. There is very little scope for switching exports of services, armaments and many types of producer goods (especially those already produced and awaiting shipment or under construction). For most raw materials and consumer goods, alternative markets will be easier to find. However, this may entail depressing prices (e.g. for tea) and/or crowding out other developing country exporters. Thus, while individual countries may be able to soften the impact of the embargo by diversifying their export markets, the net loss to developing countries may well be equal to the overall reduction of Iraqi and Kuwaiti imports from developing countries.

III. Conclusions

18. It cannot be overemphasized that the correct policy response to a payments imbalance due to an abnormal and uncertain situation is not "adjustment" but financing. There is no economic justification for altering structures of production, consumption and trade in response to a temporary loss of export revenues or turbulence in oil markets. Whereas developed countries have easy access to financing, for most other countries reserve holdings are slim, the capacity to borrow on capital markets absent, and access to compensatory financing from official sources (such as IMF) very limited. Even modest cuts in imports could have serious consequences for investment and growth, given the extent to which imports have already been squeezed. Large-scale and timely assistance, based on economic criteria, is therefore called for. The windfall gains from the oil price rise are one source among others. It is important that the efforts currently under way to raise funds should yield a volume of assistance commensurate to the damage suffered, and that the aid be distributed on an equitable basis. International co-ordination is therefore needed. The establishment of an ad hoc international compensatory facility on concessional terms also deserves serious consideration.

19. A second point warranting emphasis is the need to reduce oil price volatility, especially since it accentuates financial instability. The use of strategic petroleum reserves held by members of the International Energy Agency (IEA), which are reported to amount to 90 days' production in the Gulf, would appear to be both necessary and feasible. If the IEA were to make a publicly-announced commitment to make good any declines in oil supplies that might occur in the event of armed conflict, private demand for stocks might fall considerably. A further option meriting consideration would be a joint agreement between consumers and producers comprising both commitments on production levels and guidelines for intervention in the oil market by holders of official stocks to prick speculative bubbles. If such an agreement were reached, the readiness to release official stocks might suffice to bring prices down to jointly agreed levels and prevent excessively wide fluctuations. Admittedly, strategic reserves were not accumulated with such a purpose in mind; but many of the risks and uncertainties felt during the Cold War are now greatly reduced, if not eliminated.

20. Third, the major industrialized countries should avoid accentuating recessionary tendencies. Since interest rates are already high, further increases would be hazardous, especially in view of the precarious position of many debtor countries.

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Agenda item 1 (b)

AGENDA[1/]

1. Procedural matters:

   (a) Election of officers;

   (b) Adoption of the agenda and organization of the work of the session;

   (c) Adoption of the report on credentials;

   (d) Provisional agenda for the second part of the thirty-seventh regular session of the Board

2. Follow-up and review of the implementation of the Final Act of UNCTAD VII in accordance with Board decision 350 (XXXIV):

   - Stocktaking of the implementation of the Final Act of UNCTAD VII in preparation for UNCTAD VIII

3. Interdependence of problems of trade, development finance and the international monetary system[2/]

1/ Adopted by the Board at its 773rd meeting on 1 October 1990.

2/ Pursuant to paragraphs 7 and 8 of General Assembly resolution 44/219 and paragraphs 105 (7) and (8) of the Final Act of UNCTAD VII, and in line with the consensus recorded at the 730th plenary meeting of the Board (second part of the thirty-fourth session), it has been agreed that, in the consideration of item 3 in its entirety, delegations will be free to refer to developments and issues in the Uruguay Round of particular interest to developing countries. It has also been agreed that an informal exchange on this matter will be organized to which the Director-General of GATT will be invited.

GE.90-52363

4. Debt and development problems of developing countries

   - including discussion called for in paragraph 2 of General Assembly resolution 44/232, of 22 December 1989, on trends in the transfer of resources to and from the developing countries and their impact on the economic growth and sustained development of those countries

5. Arrangements and preparations for the eighth session of the United Nations Conference on Trade and Development

6. United Nations Programme of Action for African Economic Recovery and Development 1986 - 1990: initiation of preparations for UNCTAD's intergovernmental input into the final assessment by the General Assembly in 1991

7. Assistance to the Palestinian people (Conference resolutions 146 (VI) of 2 July 1983 and 169 (VII) of 3 August 1987)

8. Other matters in the field of trade and development[3/]:

   (a) UNCTAD's contribution, within its mandate, to sustainable development (Board decision 370 (XXXV));

   (b) Economic co-operation among developing countries:

      (i) Analyses and proposals for the facilitation of trade expansion among developing countries (paragraph 4 (f) of resolution 4 (V) of the Committee on Economic Co-operation among Developing Countries)

      (ii) Problems of trade financing in developing countries (paragraph 4 (c) (iii) of resolution 4 (V) of the Committee on Economic Co-operation among Developing Countries);

   (c) Export promotion: report of the Joint Advisory Group on the International Trade Centre UNCTAD/GATT on its twenty-third session;

   (d) Progressive development of the law of international trade: twenty-third annual report of the United Nations Commission on International Trade Law

9. Other matters requiring action by the Board arising from or related to reports and activities of its subsidiary and other bodies:

   (a) Restrictive business practices;

   (b) Invisibles and financing related to trade;

   (c) Preferences;

   (d) Shipping;

   (e) Island developing countries

3/ The inclusion of an item on UNCTAD's contribution to the preparations for the International Development Strategy for the Fourth United Nations Development Decade will depend on the outcome of consultations of the Secretary-General of UNCTAD in accordance with Board decision 373 (XXXVI).

10. Institutional, organizational, administrative and related matters:

    (a) Treatment of new States members of UNCTAD for purposes of elections;

    (b) Announcement of any changes in the membership of the Board and election to membership of main Committees;

    (c) Membership of the Working Party on the Medium-term Plan and the Programme Budget for 1991;

    (d) Designation of intergovernmental bodies for the purposes of rule 76 of the rules of procedure of the Board;

    (e) Designation and classification of non-governmental organizations for the purposes of rule 77 of the rules of procedure;

    (f) Review of the calendar of meetings;

    (g) Administrative and financial implications of the actions of the Board

11. Other business

12. Adoption of the report of the Board.

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DESIGNATION AND CLASSIFICATION OF NON-GOVERNMENTAL ORGANIZATIONS FOR THE PURPOSES OF RULE 77 OF THE RULES OF PROCEDURE OF THE BOARD

Note by the UNCTAD secretariat

1. Since the second part of the thirty-sixth session of the Board, the Secretary-General of UNCTAD has received applications and supporting documents from the following non-governmental organizations:

International Federation of Business
and Professional Women (IFBPW)

Caribbean Shipping Association (CSA)

Professional Association of Natural
Rubber in Africa (ANRA)

2. In accordance with established practice, the Secretary-General of UNCTAD consulted the Bureau of the Board on this matter on 1 October 1990.

GE.90-52369

3. The Bureau, after review, concurred with the recommendations by the Secretary-General of UNCTAD that the aforementioned non-governmental organizations be included in the list of non-governmental organizations provided for in rule 77 of the rules of procedure of the Board. The suggested classification of these non-governmental organizations into the General and Special Category is contained in the annex hereto. Background information about these non-governmental organizations is contained in documents TD/B/R.57 and Add.1-3[1/].

4. These matters are now submitted to the Board for decision.

1/ These documents are now de-restricted.

Annex

DESIGNATION AND CLASSIFICATION OF NON-GOVERNMENTAL ORGANIZATIONS FOR THE PRUPOSES OF RULE 77 OF THE RULES OF PROCEDURE OF THE BOARD

A. Recommended for General Category

International Federation of Business and Professional Women (IFBPW)	TD/B/R.57/Add.1

B. Recommended for Special Category of UNCTAD organ (other than the Board) indicated:

	UNCTAD organ	
Caribbean Shipping Association (CSA)	Committee on Shipping	TD/B/R.57/Add.2
Professional Association of Natural Rubber in Africa (ANRA)	Committee on Commodities	TD/B/R.57/Add.3

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STATEMENT OF THE HUNGARIAN DELEGATION AT THE THIRTY-SEVENTH SESSION (FIRST PART) OF THE TRADE AND DEVELOPMENT BOARD

Note by the UNCTAD secretariat

The attached statement is being circulated to members of UNCTAD at the request of the Hungarian delegation to the first part of the thirty-seventh session of the Trade and Development Board.

GE.90-52403

Mr. President,

Upon the instructions of my authorities, I would like to make the following statement.

The Government of the Republic of Hungary has decided that, from now on, Hungary will not take part in the activities of Group D in UNCTAD. Hungarian representatives to sessions of the Trade and Development Board, as well as to any other UNCTAD meetings, will act independently, outside the framework of Group D. Therefore, views to be expressed in UNCTAD in the name of, or in relation to, Group D should not be considered as reflecting or prejudging in any way the position of Hungary.

It is to be emphasized that the above decision does not prejudge the country lists included in the annex to resolution 1995 (XIX) of the United Nations General Assembly, as amended. Consequently, due account should be taken, in the future also, of the need to ensure equitable geographical distribution in UNCTAD, in line with the relevant rules of procedure.

May I take this opportunity to confirm that the Hungarian Government continues to attach great significance to UNCTAD in the system of international economic relations and to the special role UNCTAD has in seeking solutions to the problems of trade and development. Aware of the importance of an efficient intergovernmental machinery for all member States, Hungary wishes to participate to the full, further on too, in the work of all bodies of UNCTAD and in all phases of the decision-making process. To that end, the Hungarian Government is willing to co-operate and associate itself with other member States or groups of member States with respect to specific issues, on the basis of concordant interests and positions.

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ADOPTION OF THE REPORT ON CREDENTIALS

Report of the Bureau

1. The Bureau met on 10 October 1990, in accordance with rule 17 of the rules of procedure of the Trade and Development Board, to examine the credentials of the representatives of members participating in the first part of the thirty-seventh session.

2. The UNCTAD secretariat informed the Bureau that credentials, as provided for in rule 17 of the rules of procedure, had been received for all representatives participating in the first part of the thirty-seventh session of the Trade and Development Board.

3. The representative of the United States of America stated that his delegation wished to make clear that the United States remained deeply concerned about the situation in Afghanistan and that, in not pressing an objection concerning the representative of Afghanistan, the United States should in no way be considered as accepting the régime in Kabul as legitimate or representative of the Afghan people.

4. The representative of the Byelorussian Soviet Socialist Republic stated that he could only view the statement made with regard to the credentials of the representative of Afghanistan, a sovereign independent State, an active member of the movement of non-aligned countries and a full-fledged member of the United Nations, as an attempt to distort historical and political

realities. He regretted that that statement ran counter to the full and comprehensive settlement of the situation regarding Afghanistan which must be pursued through the implementation in good faith of the Geneva Accords.

5. The President proposed that the Bureau should accept the credentials of all representatives participating in the first part of the thirty-seventh session of the Trade and Development Board.

6. The Bureau, taking note of the statements made, found the credentials of the representatives participating in the first part of the thirty-seventh session of the Trade and Development Board to be in good order.